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SUBJECT: GREEK PARLIAMENT ADOPTS 2010 BUDGET: TARGETS AMIBTIOUS, BUT
SPECIFICS LACKING

REF: ATHENS 1705

Summary

¶1. (SBU) The Greek budget for 2010, which was passed by Greek Parliament on December 23, is an attempt to bring order to Greece's public finances and restore its badly-dented credibility with foreign investors, international credit ratings agencies, and the European Union. The budget aims to reduce the country's deficit from 12.7 percent of GDP in 2009 to 9.1 percent in 2010 through a series of revenue-enhancing and expenditure-reducing measures. The government has already promised to aim for a bolder deficit cut to 8.7 percent of GDP, which may be included in the January update of Greece's 3-year Stability and Growth Plan (SGP).

¶2. (SBU) Summary Continued. While many analysts believe the 2010 budget targets are probably attainable, the EU and ratings agencies see the passage of the budget and measures therein as an inadequate response to Greece's chronic and structural fiscal weaknesses. The reasons for this include the one-off nature of the measures, a less than ideal policy mix that relies too heavily on measures where the payoff is uncertain and negligible in the near-term, and the lack of vetting with and acceptance by the public, particularly major labor unions, which have already said they are planning a series of strikes to protest against planned wage freezes and/or cuts and pension reforms. These legitimate concerns, however, may mask the EU's and markets' chief complaint: the GoG's refusal to follow in the footsteps of Ireland by cutting public sector wages - a step many see as the holy grail for public sector reform and which could buy the GoG the time and credibility it needs in the short term in order to implement longer-term reforms. While most analysts and the EU are waiting for the GoG to introduce more concrete and quantifiable measures as part of the updated SGP, it remains to be seen whether anything short of wage cuts will buy their patience. END SUMMARY.

The 2010 Budget

¶3. (SBU) On December 23, following five days of sharp exchanges between the government and opposition parties, Greek Parliament adopted a crisis budget for 2010 in a bid to bring order to its

chaotic public finances and restore its badly dented credibility with foreign investors and the European Union. The budget passed by a healthy majority as the 160 Socialist deputies in power since October 2009 voted for the budget, while the entire opposition, from extreme left to extreme right, voted against. The budget aims at reducing the country's deficit from 12.7 percent of GDP in 2009 to 9.1 percent in 2010. The government has already promised to aim for bolder measures in order to reduce the deficit to 8.7 percent of GDP in 2010. This revised target may be included in an updated 3-year stability and growth plan, which will be unveiled next month. The PASOK government claimed during the debate in Parliament that the 2010 budget was the nation's "toughest" since the restoration of democracy in 1974 after seven years of military rule.

Revenues

¶4. (U) The government plans to increase net ordinary budget revenues by about 4.5 billion euros or 9 percent over 2009, following a 4.7 percent contraction over 2008. According to the GoG, additional revenues will come from the following measures:

-- 1.2 billion euros from cracking down on tax evasion and settling taxpayers' overdue debts;

-- 1.5 billion euros from an increase in tobacco, alcohol and real estate taxes;

-- 1 billion euros from a one-off corporate tax;

-- 865 million euros from the reintroduction of a progressive tax on large property holdings, inheritances and bequests (in a separate tax bill, which the GoG plans to table in March);

-- An unknown amount from the abolition of tax exemptions and a current, flat-rate tax regime for certain professional groups (in forthcoming tax bill); and

-- An unknown amount from the introduction of capital gains tax and effective taxation of offshore companies (in forthcoming tax bill).

Spending

¶5. (U) The budget provides for a decrease in ordinary spending of 1.4 billion euros or 2.3 percent over last year, following a growth of 15.9 percent in spending last year. According to the GoG, savings from expenditure cuts will come from the following measures:

-- 2.3 billion euros (or 3.8 percent savings) from a cut to primary spending (before debt payments);

-- 1.4 billion euros of savings by not repeating one-off 2009 payments to settle state hospital debts;

-- 457 million euros (or a 6.6 percent cut) of savings from defense spending cuts;

-- A 26 percent fall in ministries' operating costs, such as travel expenses and power bills; and

-- An unknown amount from a freeze on public sector wages above 2,000 euros a month (civil servants making less than that amount, however, would receive pay rises above inflation).

Macro Forecasts

¶6. (U) According to the GoG's 2010 budget, GDP is expected to shrink by 0.3 percent in 2010, a slight improvement over the 1.2 percent drop the GoG expects in 2009.Inflation is forecast at 1.4 percent against 1.2 in 2009, while unemployment will continue to rise to 9.7 percent in 2010 against 9.0 forecast in 2009. The budget projects public debt will rise to 120.8 percent of GDP, compared to 113.4 percent for 2009. The government plans to borrow up to 53 billion euros (about 22 percent of GDP) in 2010 and expects to pay out 12.95 billion euros (just over 5 percent of GDP) in interest payments next year to service the debt.

The Budget's Key Numbers

¶7. (U) The following table represents the top-line targets passed as part of the budget:

(in pct, euros bln)

	2010	2009
DEFICIT TO GDP (%)	9.1*	12.7
DEFICIT (bln)	22.176	30.557
GDP GROWTH (%)	-0.3	-1.2
GDP (bln)	244.233	240.150
PUBLIC INVESTMENT (% y/y)	+8.4	-1.3
NET ORDINARY REVENUES (%)	+9.0	-4.7
NET ORDINARY REVENUES (bn)	53.700	49.260
ORDINARY SPENDING (%)	-2.3	15.9
ORDINARY SPENDING (bln)	69.796	71.438
PUBLIC DEBT (% to GDP)	120.8	113.4

PUBLIC DEBT (bln) 294.950 272.300

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*Following the submission of the budget to Parliament in November, the GoG announced it would aim to reduce the budget deficit further to 8.7 percent of GDP next year.

Further Measures Coming

¶8. (SBU) The government has already announced a series of measures that were not included in the 2010 budget, but which the GoG has indicated will be included in an updated three-year Stability and Growth Plan to be submitted to the European Union in mid- to late-January. These measures, announced by the Prime Minister on December 14 (see reftel) include: a 10 percent cut in supplemental public sector wages (which often account for a substantial part of civil servants' salaries); a hiring freeze for permanent public sector jobs in 2010, excluding the health and education sectors, and the hiring on one new civil servant for every five retiring from 2011 onwards; a one-third reduction of all short-term employment contracts in the public sector in 2010; a 10 percent reduction in social security expenditures in 2010 (likely to be tabled to Parliament in a bill in May); a 50 percent cut in board members' pay at public enterprises in 2010; managers' pay in state-run firms will be capped and cut by at least 10 percent; no bonuses will be paid to managers of state-controlled banks, while bonuses for private bank managers will be taxed at up to 90 percent. The government has not quantified the savings that would be achieved through the implementation of these measures.

Comment

¶9. (SBU) Many local and international analysts believe the 2010 budget targets are probably attainable. However, the EU and markets see the passage of the budget, and measures contained therein, as an inadequate response to Greece's chronic and structural fiscal weaknesses. They view the measures as being largely of a one-off nature, providing little guarantee of fiscal restraint in subsequent years. The policy mix is less than ideal, with an overreliance on revenue-raising measures like a clampdown on tax evasion, which has been the aim of many governments in the past with no results. Also, cutbacks in spending are not as courageous as anticipated, and measures such as the public sector hiring freeze are expected to yield negligible results in the near-term. Finally, much depends on the degree of public support for the government's austerity measures. Already, major labor unions have announced plans for a series of one-day (or longer) strikes to protest against planned wage cuts and pension reforms.

¶10. (SBU) The key challenge facing macroeconomic policy at this time is managing to reverse unfavorable market sentiment toward Greece, according to the Bank of Greece's (the central bank) Interim Financial Stability report published the same day Parliament voted for the budget. Ambitious budget projections and additional deficit-reducing measures announced by the Prime Minister to date have not reversed this sentiment. The foremost reason for this may stem from the GoG's refusal to follow in the

footsteps of Ireland by cutting public sector wages - a step many see as the holy grail for public sector reform and which could buy the GoG the time and credibility it needs to implement longer-term reforms. While most analysts and the EU are waiting for the GoG to introduce more concrete and quantifiable measures as part of the updated SGP in January, it remains to be seen whether anything short of wage cuts will buy their patience. END COMMENT.
Speckhard